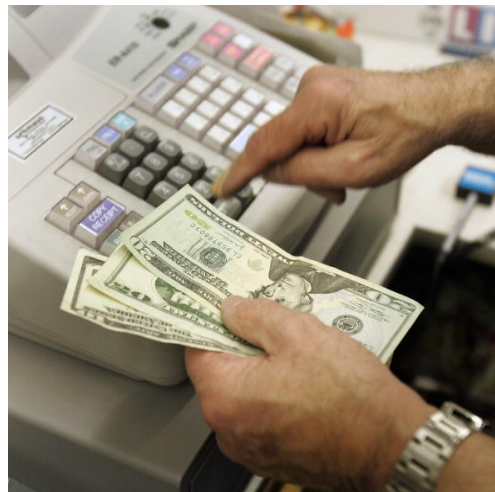


# City of Newport Beach

## Revenue Forecast



February  
2018



# City of Newport Beach Revenue Forecast

---

This publication was prepared for:

## City of Newport Beach

This publication was prepared by:

## Beacon Economics

Christopher Thornberg, PhD  
Founding Partner  
5777 West Century Boulevard, Suite 895  
Los Angeles, California 90045  
310.571.3399  
Chris@BeaconEcon.com

Robert Kleinhenz, PhD  
Economist and Executive Director of Research  
5777 West Century Boulevard, Suite 895  
Los Angeles, California 90045  
424.646.4652  
Robert@BeaconEcon.com

Justin Niakamal  
Senior Research Associate  
Justin@BeaconEcon.com

For further information about this publication please contact:

Victoria Pike Bond  
Director of Communications  
Beacon Economics, LLC  
415.457.6030  
Victoria@BeaconEcon.com

Rick Smith  
Director of Business Development  
Beacon Economics, LLC  
858.997.1834  
Rick@BeaconEcon.com

Or visit our website at [www.BeaconEcon.com](http://www.BeaconEcon.com).

Reproduction of this document or any portion therein is prohibited without the expressed written permission of Beacon Economics. Copyright ©2018 by Beacon Economics LLC.

## REPORT OVERVIEW

This revenue forecast for the City of Newport Beach extending to 2021–22 uses standard time-series econometric techniques based on historical correlations and forecasts of economic trends. **Beacon Economics'** method of forecasting takes a layered approach: National policy changes and external shocks are built into a U.S. model with a variety of economic indicators: GDP, production, demographics, interest rates, government spending, taxes, savings, income growth and real estate. **Beacon** then crafts a California model that incorporates macro trends at the national level with statewide trends in employment/labor markets, demographics, real estate and business activity.

Taking into account these state and national factors, **Beacon** creates a regional model for Orange County using macro trends to generate a local forecast that delivers a broad outlook for the region, comprising:

- Employment by industry
- Unemployment
- Consumer spending and income trends
- Population and components of change
- Residential and nonresidential real estate and construction.

The regional assessment highlights major drivers at the national level, continues with developments in the State of California, and zooms in on the economy of Newport Beach to forecast its major revenue streams extending to 2021–22.

### City of Newport Beach Revenue Forecast

Revenue Stream	Actual	Forecast				
	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Assessed Value (\$ 000s)	50,468,451	53,779,181	57,732,443	61,471,384	65,252,153	69,180,128
Growth(%)	6.5	6.6	7.4	6.5	6.2	6.0
Property Tax	78,501,042	83,650,711	89,799,804	95,615,531	101,496,320	107,606,080
Growth(%)	7.2	6.6	7.4	6.5	6.2	6.0
Taxable Sales (\$ 000s)	3,054,818	3,179,833	3,349,996	3,514,521	3,680,256	3,844,525
Growth(%)	0.9	4.1	5.4	4.9	4.7	4.5
Sales and Use Tax	34,356,176	35,762,170	37,675,914	39,526,254	41,390,206	43,237,659
Growth(%)	-0.9	4.1	5.4	4.9	4.7	4.5
Transient Occupancy Tax	27,208,671	28,212,240	30,853,767	32,541,371	34,417,827	36,485,966
Growth(%)	5.9	3.7	9.4	5.5	5.8	6.0
Building Permit Valuations	448,022,148	461,217,798	486,448,565	500,655,766	518,157,794	536,452,021
Growth(%)	65.6	2.9	5.5	2.9	3.5	3.5

Source: Forecast by Beacon Economics

## NATIONAL AND STATE ECONOMIES

The local economy is heavily dependent on the national and state economies. In the most recent edition of *Beacon Economics* (free at [www.BeaconEcon.com](http://www.BeaconEcon.com)), **Beacon Economics** analyzes national and state economic trends in depth. Below is a summary of what **Beacon** sees happening in the U.S. and California economies.

### **United States Economy**

- From a political standpoint 2017 will go down as one of the most chaotic periods in recent U.S. history, although it may well end up being overshadowed by 2018. Economically, on the other hand, 2017 was fairly ho-hum. While ho-hum may not excite, the sure and steady growth carries with it another advantage. The U.S. economy is now in the 9th year of its current expansion, and at this point there is little reason to believe that will end in 2018.
- The nation's slowing job growth is not due to a lack of labor demand-the job openings rate has been at or near an all-time high for the last few months. Instead, the slowdown in employment growth stems from a lack of available workers. The U.S. unemployment rate is now 4.1%, the lowest in 45 years with the exception of a few months during the massive tech bubble of the late 1990s-and today, the nation is not experiencing a major bubble of any kind.
- The GOP's tax overhaul is mainly a massive cut in corporate taxes and an attempt to offset the loss in revenue by removing certain tax benefits. Putting aside the clearly regressive nature of this plan, no credible economist on record believes the proposal will have anywhere near the growth impact needed to pay for itself.
- The recent tax overhaul will have another unintended consequence for the U.S. economy-higher rates and tighter lending markets. As noted, one of the primary features of the tax proposal is that it will lead to more government borrowing, which is broadly stimulative to the economy. But such stimulus is only desirable when there is slack in the system. At this point, no such slack exists.
- On the surface, 2018 looks to be a lot like 2017 in terms of economic growth. But dig a little deeper and growing frictions become apparent. These will begin to create problems in the economy in 2019 or beyond. So enjoy the current economic calm-before long, the ride is going to grow bumpy.

### **California Economy**

- California's unemployment rate is higher than the U.S. rate, but the differential between the two is now at its lowest in over 10 years. Looking across the state, a number of California counties have unemployment rates under 3%, but a few face rates above 7%, in many instances due to the composition of industries and substantial seasonal employment in those counties.
- Job gains overall and by industry have generally slowed significantly compared to recent years. To be sure, this slowdown is not symptomatic of a looming recession, but a shortage of workers. Following a 1.1% surge in 2016, the statewide labor force slowed to a growth pace of 0.6% in 2017, just two-thirds of the average rate since 1990.
- Other measures point to continued progress in the state economy. In the second quarter of 2017, California's Gross State Product increased by 2.6%, adjusted for inflation, the eighth fastest among the states and nicely ahead of the overall U.S. growth rate of 2.0%. California continues to be among the ranks of the faster growing states, a constant source of surprise to its naysayers.
- The near-term picture for housing looks good, but long-term problems require attention now. Home sales have edged up, but the statewide homeownership rate remains stubbornly low because of unaffordably high prices. At the same time, rents have increased steadily in many parts of the state in the face of low apartment vacancy rates.
- Historically, middle-income households in California have been able to count on the deductibility of mortgage interest and property taxes to soften the blow. The new tax plan will cut the limit on mortgage interest deduc-

tions from \$1 million to \$750,000 and also impose a \$10,000 limit on state and local tax deductions. This will put the American Dream of homeownership further out of reach for more California residents.

- Another long-term concern is the gulf between pension obligations and pension funding for state and local governments, which has widened in recent years and will continue to do so over the foreseeable future. Jurisdictions face a difficult choice: They can divert current revenues to pay down pension obligations, but this may diminish services to residents and much needed expenditures on infrastructure.

## CITY OF NEWPORT BEACH REVENUE FORECAST

**Beacon Economics'** current forecast for the City of Newport Beach continues to assume a baseline trajectory for the national economy. Corporate tax cuts should boost investment spending on the part of Orange County firms. Meanwhile, personal tax cuts will leave households with more disposable income, some of which will be spent in the local economy. Both of these will speed GDP growth in the near term and boost local economic activity. **Beacon** will monitor the situation and reassess as new information becomes available.

### Real Estate Driven Revenues

The City's revenues most closely associated with local real estate continue to grow, with prices and sales for existing single-family residences surging in 2016–17. The current forecast is calling for continued increases in real estate-driven revenue as home price growth and construction activity support growth in the near term.

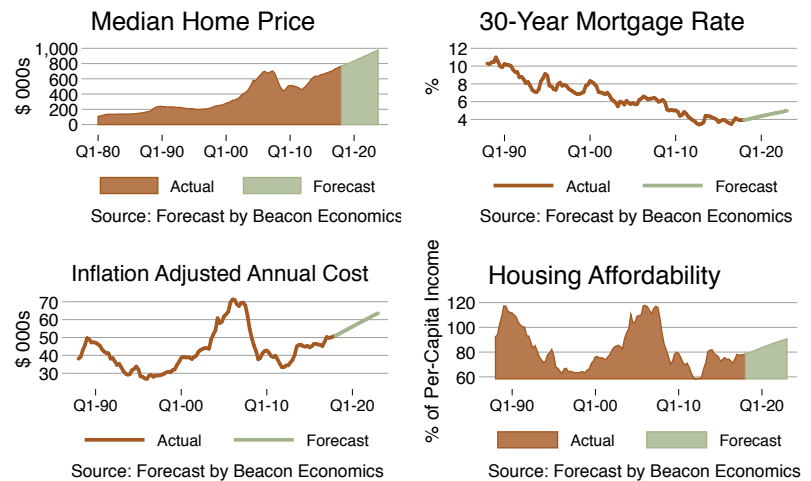
Citywide home sales for 2016–17 were 7.6% higher than in 2015–16, substantially improved from the 1.4% decline in home sales in the prior fiscal year. In our annual forecast last year, home sales were predicted to increase moderately over the prior fiscal year, with mortgage rates near historic lows.

The federal tax law that passed in mid-December will change the playing field for state residents, especially in areas such as Newport Beach, where home prices are well above average. The homeownership rate in California is already considerably lower than in the United States as a whole, mainly because the median home price is more than twice that of the nation. Historically, middle-income households in California have been able to count on the deductibility of mortgage interest and property taxes to soften the blow.

The new tax law allows homeowners to deduct interest on up to \$750,000 of mortgage acquisition debt, and imposes a \$10,000 limit on state and local tax deductions. This will put the American Dream of homeownership further out of reach for more California residents. In Newport Beach, where the median price of a home was \$2,061,500 in the

## Orange County Home Price Outlook

*Prices maintaining upward trajectory*





fourth quarter of 2017, many property owners will be affected by these new limits. But they will benefit from lower income tax rates. Home price growth in the City has held steady above historical norms in the past year, which has helped keep AV and transfer tax revenue growth in positive territory. For 2016–17, the median resale price was \$1.96 million, a 6.3% increase over the first half of the prior fiscal year. This was an improvement over the 5.8% rate of growth for all of 2015–16.

Construction activity is also trending above expectations. During 2016–17, 709 new residential units were permitted, a 345.9% increase over the prior fiscal year, an unusually slow permitting period. Nonresidential permitting also picked up considerable momentum in 2016–17, with the total value up 34.8% over the prior fiscal year.

Finally, inflation as reflected in the California Consumer Price Index (CPI) has been rising in the most recent data. This bodes well for AV growth for properties not changing hands. In December, the California CPI reading came in at 265.7, a 2.9% increase over December 2016. Although it is the October-to-October number that matters, this latest data point fits the overall trend of rising consumer prices as the plunge in energy prices moves further into the past.

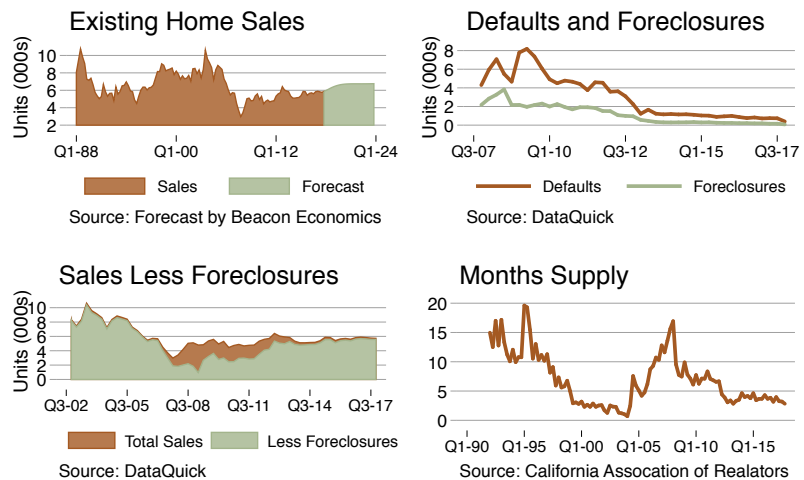
### **Business Activity Driven Revenues**

The City's revenues that are driven primarily by consumer and business spending were notably weak in 2016–17, but this is more the result of transitory developments than a change in the broader trend of economic growth in the region. Lower fuel prices were part of the problem, but as oil prices continue to stabilize, this effect will subside. The outlook for the regional economy is good, and spending growth is expected to continue in line with historical averages.

As measured by the region's labor market, local economic health is a mixed bag. From 2016 to 2017, total nonfarm employment in Orange County increased a tepid 0.7%. This figure comes directly from the Current Employ-

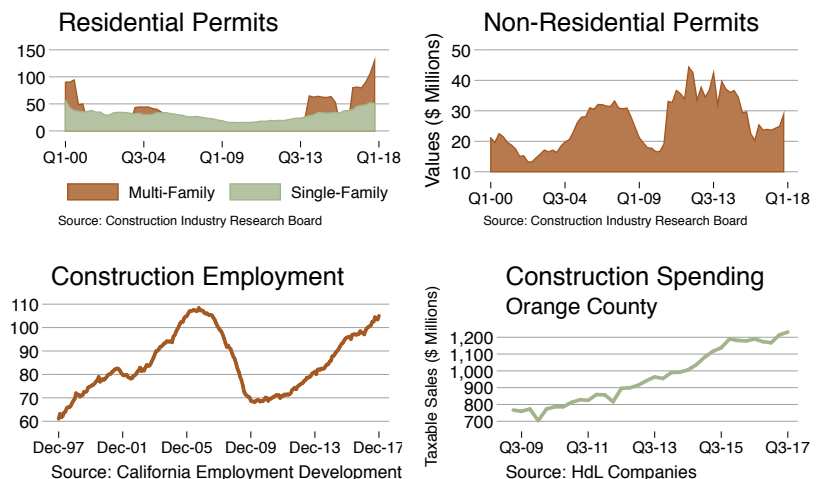
## **Orange County Home Sales Outlook**

*Market inventories remain near post-recession lows*



## **Newport Beach Construction Trends**

*Steadily trending higher from recession lows*



ment Statistics, however, which is a survey of establishments. It is subject to an annual revision each March when it is benchmarked against the Quarterly Census of Employment and Wages, a more complete data source but one that is subject to lengthy reporting lags. Based on a comparison of these two sources, **Beacon** expects Orange County employment figures to be upwardly revised in March.

The City's sales tax revenue was tepid in 2016–17, rising less than a percent over the prior fiscal year. The impacts from the Tax Cuts and Jobs Act will be broadly simulative and should help support nominal taxable sales growth.

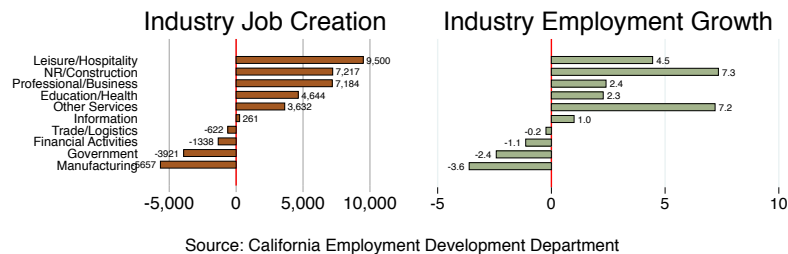
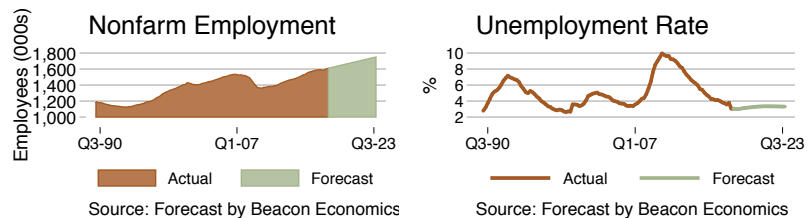
Although individuals in the upper end of the tax bracket will experience the largest break in terms of overall tax burden, they tend to have a lower marginal propensity to consume. In other words, the marginal impact from an increase in disposable income is relatively low compared with individuals in the middle and lower-income brackets. Nonetheless, the increase in disposable personal income should yield an increase in taxable sales in the short term in 2018 and possibly into 2019.

## SUMMARY

**Beacon Economics'** forecast represents an optimistic outlook through 2021–22 and assumes that the U.S. economy will grow at a moderate pace, much as in recent years. Although the federal tax overhaul is in the rearview mirror, other policy changes may lie ahead, lending inherent uncertainty to this forecast. **Beacon** will closely monitor policies as they are announced and enacted and will adjust its economic outlook accordingly.

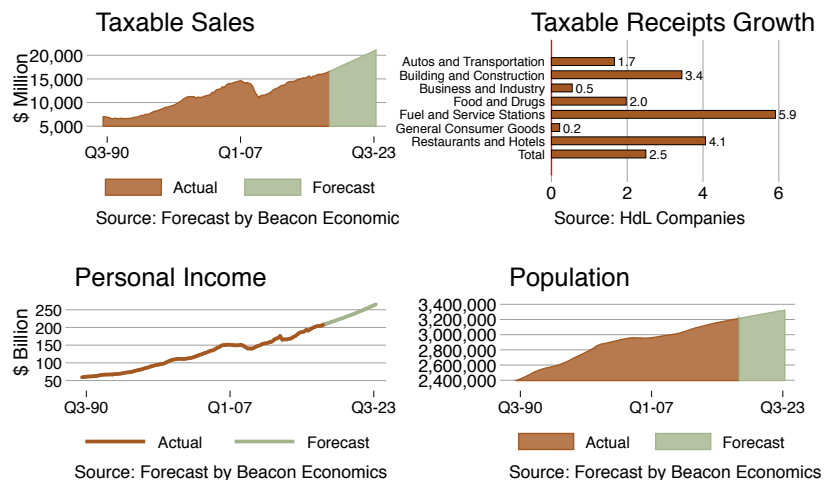
## Orange County Labor Market

*Labor market remains on post-recession upward trend*



## Orange County Spending and Income

*Rebound in energy prices supporting nominal growth*



## ABOUT BEACON ECONOMICS

Beacon Economics, LLC is a leading provider of economic research and forecasting, industry analysis, public policy analysis, and economic data services. By delivering independent, rigorous analysis, we give our clients the knowledge they need to make the right strategic decisions about investment, growth, revenue, and policy. Learn more at [www.BeaconEcon.com](http://www.BeaconEcon.com).

### SERVICES

- Economic and revenue forecasting
- Economic impact and fiscal analysis
- Regional economic analysis
- Public policy analysis
- Real estate market analysis
- Industry and market analysis
- EB-5 Visa analysis

### CONTACTS

- **Sherif Hanna**  
Managing Partner  
(424) 646-4656  
[Sherif@BeaconEcon.com](mailto:Sherif@BeaconEcon.com)
- **Rick Smith**  
Director of Business Development  
(858) 997-1834  
[Rick@BeaconEcon.com](mailto:Rick@BeaconEcon.com)
- **Victoria Pike Bond**  
Director of Communications  
(415) 457-6030  
[Victoria@BeaconEcon.com](mailto:Victoria@BeaconEcon.com)